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IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

HARTFORD FIRE INSURANCE CO., *et al.*,
Petitioners,

v.

STATE OF CALIFORNIA, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF AMERICAN INSURANCE ASSOCIATION, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS, NATIONAL COUNCIL ON COMPENSATION INSURANCE, AND THE SURETY ASSOCIATION OF AMERICA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICI CURIAE*

Amici curiae are insurance trade associations and insurance rating organizations whose member insurers write property and casualty and workers' compensation insurance throughout the United States.[1]

The American Insurance Association ("AIA") is a national trade organization representing over 250 insurers writing property and liability and workers' compensation insurance for businesses, homeowners, automobile drivers, and others. The National Association of

[1] Petitioners and respondents have consented to the filing of this brief. Copies of the parties' consent letters have been filed with the Clerk.

Independent Insurers ("NAII") is a national trade association comprised of more than 560 insurers writing all varieties of property and casualty insurance as well as workers' compensation insurance.

The National Council on Compensation Insurance ("NCCI") is a state-licensed rating and advisory organization that prepares and files rates and rating plans for workers' compensation and employers' liability insurance. The Surety Association of America ("SAA") is also a licensed rating or advisory organization that develops standardized fidelity bond forms similar to the standardized forms at issue in the present litigation.

The *amici curiae* and their member insurance companies have a vital interest in the outcome of this case because it will substantially affect their ability to develop and use standardized forms. Standardized coverage terms are essential to the effective functioning of property and casualty insurance markets.

A principal objective of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-15, was to permit the states to authorize industry cooperation on forms, by granting such joint action an exemption from the antitrust laws. The court of appeals nonetheless denied McCarran Act antitrust immunity to industry practices that are integral to the reaching and implementation of an industry consensus on standardized policy language. The *amici*'s brief will focus on the McCarran Act's legislative history demonstrating that, contrary to the court of appeals' conclusion, the practices challenged here are essential to the standardization of policy forms and thus a critical feature of the industry cooperation that Congress intended to immunize.

INTRODUCTION AND SUMMARY OF ARGUMENT

The McCarran-Ferguson Act affords an antitrust exemption for the "business of insurance" to the extent it is "regulated by State law." 15 U.S.C. § 1012(b). Plaintiffs' Sherman Act claims, which challenge the standardi-

zation of general liability insurance policy forms, target conduct at the heart of this exemption.

Standardized insurance policy forms are critical to the accurate pricing of the insurance product. Without standard definitions of risk, it would be impossible for the industry to pool the data on past losses that is crucial for ratemaking. In enacting the McCarran Act, Congress thus regarded industry cooperation on rates and forms as inseparable and essential: "Uniformity as to rates, forms of policies and the like, is not only desirable in insurance, but is necessary." S. Rep. No. 1112, 78th Cong., 2d Sess. 6 (1944). Standardized coverage terms are also at "the core of the 'business of insurance'" because they determine "the type of policy which could be issued, [and] its reliability, interpretation, and enforcement. . . ." *SEC v. National Sec., Inc.*, 393 U.S. 453, 460 (1969). In short, the insurance industry "could not cease to use standard forms without at the same time ceasing to be an insurance business." C. L. Squires, *A Skeptical Look at the Doctrine of Reasonable Expectation*, 6 Forum 252 (1971).

For these reasons, all fifty states authorize insurers, acting through state-licensed rating or advisory organizations, to develop standardized forms subject to regulatory supervision and review. Indeed, the standardized coverages at issue in this case, Commercial General Liability ("CGL") policy forms developed by defendant Insurance Services Office, Inc. ("ISO"), were given unprecedented state scrutiny.

Those forms were developed in response to the "rapidly expanding crisis in liability insurance availability and affordability" that emerged during the early and mid-1980s. United States Department of Justice, *Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability* at 1 (Feb. 1986). "Developments in tort law [were] a major cause" of the crisis. *Id.* at 2. Insurers faced explosive growth in new types of "toxic tort" claims for "long latency" injury, especially

claims against asbestos manufacturers. After the federal Superfund Act was passed in 1980, insurers also experienced a totally new type of claim for hazardous waste-site "clean up" costs. Judicial liberalization of tort liability rules and expansionist readings of the coverage terms of standardized CGL policies made it increasingly difficult for insurers to assess their exposure to these claims. *See, e.g.*, K. Abraham, *Making Sense of the Liability Insurance Crisis*, 48 Ohio St. L.J. 399, 404-09 (1987).

Insurers reacted by revising their standardized CGL forms to minimize the uncertainty that had prevented accurate pricing of their product, hindered its availability, and potentially threatened their financial condition. As the General Accounting Office explained, "[m]ore precise contract language addressing these specific risks could make court interpretations of the contracts more predictable." General Accounting Office, *Hazardous Waste: Issues Surrounding Insurance Availability*, RCED-88-2, at 73 (Oct. 1987).

Insurers altered the standardized CGL policy forms to eliminate most coverage for pollution-related risks, which, instead of being automatically included in the basic policy, was offered as an optional endorsement and under two separate pollution liability forms. *See* Affidavit of Carole Banfield ("Banfield Aff.") ¶ 15. They also limited the period during which the policies covered claims, thus permitting more predictable assessment of future losses. *See id.*

In part, these changes were made because of insurers' increasing inability to obtain reinsurance. As one regulator noted, "[b]ecause of the difficulty in underwriting the current CGL policy, reinsurers are increasingly opposed to sharing the risk of loss on such lines of coverage. . . . The reduction of reinsurance has had the immediate effect of reducing the direct writing insurers' ability to accept new risks, and necessitated substantial premium increases to maintain necessary reserves." *See id.* App. N (decision by Connecticut Insurance Commissioner, Dec. 31, 1985).

Undeniably, the changes in the CGL forms were controversial. They sparked opposition from many commercial lines policyholders and state officials representing governmental purchasers of general liability insurance. *See id.* ¶¶ 17-18. It was precisely because of this controversy, and the continuing crisis in the availability of basic commercial insurance, that state insurance departments during the period 1984-87 subjected the ISO forms to intensive regulatory oversight. At the end of this prolonged scrutiny, the vast majority of states approved the ISO proposals. *See id.* ¶¶ 17-20.

The plaintiff attorneys general disagreed with regulatory approval of the ISO forms, which several of them had opposed during the course of insurance department hearings. *See id.* ¶ 11. They also asserted that "[t]he conspiratorial action of these companies created the so-called liability crisis," not "the need to finance costly lawsuits and huge settlements." News Release by Commonwealth of Massachusetts Attorney General's Office at 2, 3 (Mar. 22, 1988).

Plaintiffs accordingly filed the present Sherman Act claims to override state approval of the ISO forms by means of an injunction directing ISO to promulgate the substantially different standardized coverages desired by plaintiffs. Plaintiffs also sought to restructure ISO from a private organization into a quasi-governmental agency dominated by "public interest" members. *See, e.g.*, Complaint of State of California ("Cal. Compl.") ¶¶ 163, 168; *Hearing Before the Subcomm. on Antitrust, Monopolies and Business Rights of the Comm. on the Judiciary on S. 1299*, 100th Cong., 2d Sess. 114-15, 130 (1988). Unless reversed, the ruling below will permit the plaintiffs to proceed with their attempt to supersede state decisions about insurance forms and to alter radically the primary vehicle for industry cooperation—state-licensed rating organizations—that the McCarran Act authorized the states to create.

The lower court's decision was based on two fundamental misunderstandings about standardization of in-

surance policy forms that infected its McCarran Act analysis. First, the court of appeals failed to recognize that one of the main reasons why primary insurance coverage terms are standardized is to maximize the availability of reinsurance. This led the court to misperceive the give-and-take between insurers and reinsurers over the reinsurability of proposed coverages as improper attempts to influence insurer decisions coercively.

The lower court conceded that the forms standardization activities of the domestic defendants were "regulated by State law" as required by § 2(b) of the McCarran Act, 15 U.S.C. § 1012(b). It held, however, that the U.S. defendants forfeited this immunity by allegedly conspiring with foreign reinsurer defendants beyond the reach of state jurisdiction. Pet. App. 19a-20a. The court also concluded that the defendants' opposition to the forms initially proposed by ISO, based on reinsurer unwillingness to reinsure those coverages, sufficiently alleged "boycott, coercion, or intimidation" falling within the exception to the exemption in § 3(b) of the Act, 15 U.S.C. § 1013(b). Pet. App. 20a-25a. In effect, the court of appeals ruled that the McCarran Act antitrust exemption for form standardization is nullified by the involvement of reinsurers, whether domestic or foreign.

The legislative history demonstrates, however, that an important function of form standardization is to maximize the availability of reinsurance. Reinsurers share in the risks underwritten by primary insurers and thus will extend their coverage only if they are satisfied that the underlying insurance policies will not impose unacceptable risk.

As a result, what the appellate court regarded as a non-exempt "boycott"—efforts by insurers to determine whether reinsurers will underwrite their proposed coverages—is actually an integral feature of the standard-setting process of which Congress was aware and which it fully intended to immunize. By exposing insurers to antitrust sanctions for this interaction with reinsurers,

the decision below threatens to create a "Chinese wall" between insurers and reinsurers that will constrict the access of U.S. underwriters to domestic and global reinsurance markets.

In addition, the "forfeiture of immunity" principle fashioned by the lower court threatens to shut out from the form standardization process not only foreign reinsurers but also numerous other interested persons. Unregulated parties, especially policyholders and associations of agents and brokers, have a direct interest in policy terms and regularly express their positions on proposed forms to insurance rating organizations. After the lower court decision, however, insurers risk losing their antitrust immunity by dealing with such "non-exempt" persons notwithstanding that the insurers, their rating organizations, and their forms are fully subject to state regulation. This threat of antitrust sanctions will have the perverse result of making the form standardization process a closed one, contrary to the McCarran's Act's policy of encouraging open access to rating organizations.

The appellate court also failed to grasp the interrelationship between form standardization and collective ratemaking. This led it to the erroneous assumption—made without any analysis whatsoever—that ISO's decision to terminate rate statistical support for an obsolete standardized form was a "boycott" rather than a logical incident of promulgating a new industry standard.

This ruling may impel rating organizations, out of fear of antitrust sanctions, to continue providing statistical support for superseded policy forms. The lower court's decision thus repudiates the judgment of Congress that the states should be free to restrict competition in policy forms and authorize a single industry standard.

ARGUMENT

I. THE McCARRAN ACT EXEMPTS THE PRACTICES CHALLENGED IN THESE CASES BECAUSE THEY ARE NECESSARY AND INCIDENTAL TO INDUSTRY STANDARDIZATION OF INSURANCE POLICY FORMS.

Although the court of appeals characterized the complaints as broadly alleging an agreement "to refuse reinsurance for CGL risks" so as to coerce "ISO and ISO members to adopt the terms the defendants wanted," Pet. App. 21a, the form standardization counts of the complaints[2] do not, in fact, allege any such sweeping refusal.

[2] Plaintiffs essentially alleged two categories of violations, only one of which relates to form standardization. First, they contended that certain of the defendant insurers and reinsurers coerced non-defendant members of ISO to support changes in standardized CGL policy forms, which were then submitted to state regulators for their approval. Plaintiffs similarly complained of ISO changes in the terms of "excess and umbrella" policies but did not allege the use of "boycott" or "coercion" to compel those changes. *See, e.g.*, Cal. Compl., First, Second, Third, Fourth and Seventh Claims; Complaint of the State of Connecticut ("Conn. Compl."), Second and Sixth Claims.

Second, plaintiffs alleged that, after the ISO proposals were approved and the forms began to be used in the market, certain of the reinsurer defendants coerced insurers to use only the "claims made" CGL form approved by regulators, not the "occurrence" form also approved by the states, by threatening the denial of reinsurance if the latter were used. Plaintiffs also asserted a similar denial of reinsurance for commercial property policies that covered pollution risks. *See, e.g.*, Cal. Compl., Fifth, Sixth and Eighth claims; Conn. Compl., Third, Fourth and Fifth claims.

Because of the central importance of the development of standardized forms to the state-regulated business of insurance, this brief focuses on the plaintiffs' boycott claims insofar as they relate to the development of the ISO standardized forms. In addition, however, *amici* also agree with defendants' submission that, insofar as plaintiffs allege a boycott based on the foreign reinsurers' alleged agreement not to write reinsurance for certain primary coverages, such conduct does not give rise to a boycott and as a matter of law falls within the McCarran Act's immunity from the antitrust laws.

Plaintiffs assert only that defendants threatened not to sell reinsurance for the coverages *proposed* to state regulators by ISO in 1984, but which never became effective and which were superseded by the 1986 ISO proposals favored by defendants. For example, plaintiffs assert that defendants "agre[ed] to boycott the 1984 ISO CGL forms, unless they were amended to comply with defendants' terms." Cal. Compl. ¶ 114(b); Conn. Compl. ¶ 123(b). There is no allegation of an absolute cutoff of reinsurance, a denial of reinsurance for existing CGL coverages, or a refusal to sell types of reinsurance unrelated to the proposed coverages.

The effect of the lower court's boycott ruling, therefore, is that insurers and reinsurers lose their immunity when they jointly oppose a proposed standardized coverage by saying they will not reinsure it. Influencing negotiations over new standardized coverages through statements of unwillingness to reinsure, however, are instrumental to the development of uniform policy language. As the legislative history demonstrates, an important purpose of form standardization is to assure the availability of reinsurance—an objective that can be fulfilled only by assessing reinsurer acceptance of proposed terms.

A. Congress Intended to Immunize Negotiations Between Insurers and Reinsurers on Standardized Policy Forms Because They Play a Critical Role in Assuring the Availability of Reinsurance.

Product standardization plays a uniquely central role in insurance and reinsurance markets, as was recognized by the authors of the McCarran Act. Shortly before the Act's passage, standardized policies were in widespread use. *See, e.g.*, 90 Cong. Rec. 6,556 (1944) (remarks of Rep. Graham) ("the States have established uniform fire insurance policies, so that today 31 States prescribe standard forms of policies that must be used").

However, industry cooperation on forms was placed into jeopardy by the decision in *United States v. South-Eastern*

Underwriters Ass'n, 322 U.S. 533 (1944), which held that insurance was interstate commerce subject to the Sherman Act. The National Association of Insurance Commissioners ("NAIC") became concerned that the threat of antitrust prosecution would "impair some of the cooperative procedures on rates, forms and operating practices long recognized as essential to the sound conduct of the insurance business and to the protection of the public." 90 Cong. Reg. A4,406 (1944).

Consequently, the NAIC proposed to Congress an antitrust exemption that, among other things, would have immunized "any agreement or concerted or cooperative action which prescribes . . . insurance policy or bond forms. . . ." *Id.* Although the NAIC's "specific list of exempted activities was not included in the law ultimately enacted," nevertheless "[t]he views of the NAIC are particularly significant, because the Act ultimately passed was based in large part on the NAIC bill." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221, 222 & n.28 (1979).

Congress eventually agreed with the NAIC that an antitrust exemption was needed to preserve cooperation on forms. The legislature feared that "[a] State law . . . relating to regulation, for instance, . . . the fixing of the terms of a contract of insurance . . . might under some definitions of monopoly be monopolistic." 91 Cong. Rec. 480-81 (1945) (remarks of Sen. Ferguson).

A principal purpose of the McCarran Act, therefore, was to exempt form standardization because of its special importance to the insurance business: "Congress should not permit a broadening of the antitrust laws which will result in rendering insurance open to the caprices of free competition, for it is a matter of common knowledge to those who are informed that insurance is something quite different from the ordinary commercial transaction. . . . Uniformity, as to rates, *forms of policies* and the like, is not only desirable in insurance, but is necessary if the business of insurance is to be conducted to meet the needs

and requirements of all businesses and all persons." H.R. Rep. No. 873, 78th Cong., 1st Sess. 8 (1943) (emphasis added).

Congress specifically intended to permit the states to authorize industry cooperation on forms through the mechanism of licensed rating organizations, such as defendant ISO and *amici curiae* NCCI and SAA. *See, e.g.*, 91 Cong. Rec. 1,481 (1945) (remarks of Sen. Ferguson) ("This bill would permit—and I think it is fair to say that it is intended to permit—rating bureaus. . . ."); 90 Cong. Rec. 6,627 (1944) (remarks of Sen. Ferguson) ("But certain things are essential, at least in the opinion of many of the States, and one is a rating bureau.").[3]

Congress decided to exempt form standardization from the antitrust laws for several reasons. After *South-Eastern Underwriters*, the "primary concern of both representatives of the insurance industry and the Congress was that cooperative ratemaking efforts be exempt from the antitrust laws." *Royal Drug*, 440 U.S. at 221. Standardized forms are essential to collective ratemaking. *See, e.g.*, 90 Cong. Rec. 6,531 (1944) (remarks of Rep. Satterfield) ("It would seem at first glance unreasonable not to allow individual companies to write coverages which differ from the approved standard coverages. However, from an actuarial standpoint, it would be impossible to accumulate sufficient loss experience on one company's business to determine whether or not the premium charge is proper"). Congress also regarded form standardization as a useful tool for state solvency regulation and consumer protection. *See, e.g.*, H.R. Rep. No. 873, *supra*, at 9 ("The most accurate determination of . . . forms of policy is desir-

[3] Although Congress' principal focus was on the standardization of policy forms through rating organizations, it more generally intended to exempt all state-regulated joint action on insurance policy terms and conditions. *See, e.g.*, 90 Cong. Rec. 6,636 (1944) (remarks of Rep. Howell) ("Uniformity as to rates, forms of policies, *terms, and conditions* is necessary in insurance but it is only possible as a result of joint action and cooperation") (emphasis added).

able also in preserving the solvency of insuring companies. . . ."); 90 Cong. Rec. 6,538 (1944) (remarks of Rep. Springer) ("under State regulation . . . we have uniform contracts which fully protect the insured.").

For present purposes, however, Congress' most important reason for exempting form standardization was that it promotes the availability of reinsurance. Indeed, the legislators regarded standardized forms as even more significant for access to reinsurance than for the sale of insurance:

> Uniformity, and knowledge in advance of what rates and policies will be, is desirable for the public, and is necessary in the functioning of insurance companies and organizations. This is particularly true in the case of reinsurance or the participation by a number of insuring companies in the same risks. No company could safely agree in advance to reinsure, unless it knew what the terms of its obligation would be and the consideration therefor. Lack of agreement in advance would therefore be detrimental to public service by insuring companies.

H.R. Rep. No. 873, *supra*, at 9; *see also* 90 Cong. Rec. 6,527 (1944) (remarks of Rep. Miller) ("Just how could the fire insurance business be conducted successfully if the companies are not going to be permitted to get together and agree on rates, forms, and the establishment of rating bureaus? How could there be reinsurance? . . . If we did not have uniform rates and forms, how could such reinsurance be placed?"); *id.* at 6,528 (remarks of Mr. Miller) ("Reinsurance—a very essential phase of this business—represents a clear illustration of the necessity for uniform rates and agreement upon rates in advance. If rates are not uniform and agreed upon in advance, each reinsurance transaction will involve negotiations between the insurer and all of its reinsurers, and this will involve such delay and expense as to make impossible the expeditious insurance of large risks").

Standardized forms and reinsurance availability are linked because insurers and reinsurers are risk-sharing partners. In a reinsurance transaction, an insurance company (the "primary insurer") enters into a contract with a reinsurer under which the reinsurer assumes part of the risk of the primary insurer's policies. When a policyholder of the primary insurer incurs a loss that the primary insurer must pay, the reinsurer becomes liable to the primary insurer for part of the loss. Thus, reinsurance can aptly be described as "insurer's insurance."

Because reinsurance spreads risk from the insurer to the reinsurer, it enables primary insurers to underwrite risks that otherwise would be too large for any one company to handle. *See, e.g., The Pricing and Marketing of Insurance: A Report of the Department of Justice to the Task Group on Antitrust Immunities* 209 (Jan. 1977) (reinsurance "provid[es] capacity and spread[s] risk which no single insurer could or would assume alone."). In other cases, insurers purchase reinsurance to protect themselves from a disastrous accumulation of losses arising from a single catastrophic event, such as a hurricane or an earthquake. Insurers also purchase "aggregate loss reinsurance" to cap the total losses to which they are exposed over a specific time period. Additionally, where a primary insurer has too much business concentrated in a particular geographic area or in a particular line of insurance, reinsurance allows the carrier to reduce the possibility that the results in that market could cause inordinate losses. Finally, where a primary insurer wishes to enter a market for a type of coverage it has not previously provided, it can do so most prudently at first by ceding a large portion of the new coverage to an experienced reinsurer and benefitting from the reinsurer's expertise.[4]

In these ways, reinsurance limits an insurer's loss exposures to levels commensurate with its capital and

[4] *See generally* J. Butler & R. Merkin, *Reinsurance Law* § A.1.1 (1992); M. Pollack, *The Reinsurance Contract*, in *Reinsurance Contract Wording* 2-5 (R. Strain ed. 1992); H. Kramer, *The Nature of Reinsurance*, in *Reinsurance* 28-29 (R. Strain ed. 1980).

surplus, thus allowing the company to offer coverage in excess of what it could otherwise provide. Reinsurance also enhances competition by allowing smaller insurers to compete for business that could otherwise be handled only by larger insurers. In short, the underwriting capacity of U.S. primary insurers is significantly enhanced through the purchase of reinsurance.

As Congress recognized in 1945, however, the availability of reinsurance is heavily dependent on reinsurer acceptance of standardized coverages. This is because the reinsurer assumes a portion of the risks as defined in the primary insurance policy. *See* B. Ostrager & T. Newman, *Handbook on Insurance Coverage Disputes* 460 (4th ed. 1991).

The customary rule of reinsurance contracts is that the reinsurer "follows the fortunes" of the primary insurer, meaning that the liabilities of the reinsurer and primary insurer are identical within the financial ceilings set forth in the reinsurance contract.[5] As one commentator explains, "[t]he reinsurer assumes the risks written by the direct insurer in his original policies at the original conditions stipulated therein." I K. Gerathewohl, *Reinsurance Principles and Practice* 464 (1980).

Because the terms of the primary insurance policy control the scope of reinsurance, reinsurers have a legitimate interest in providing their views on those terms during the development of standardized forms. Due to the dominance of standardized coverages in the market, if reinsurers cannot express their concerns during the standard-setting process, the forms ultimately adopted may be unfavorable from the reinsurers' perspective and limit their willingness to reinsure. Conversely, primary

[5] *See generally* I K. Gerathewohl, *Reinsurance Principles and Practice* 711 (1980); J. Butler & R. Merkin, *Reinsurance Law* § C.1.4 (1992); *Bellefonte Reinsurance Co. v. Aetna Cas. & Sur. Co.*, 903 F.2d 910 (2d Cir. 1990); *American Marine Ins. Group v. Neptunia Ins. Co.*, 775 F. Supp. 703, 708 (S.D.N.Y. 1991), *aff'd*, 961 F.2d 372 (2d Cir. 1992).

insurers have an interest in soliciting the views of reinsurers at the standard-setting stage, since reinsurers may later decline to provide coverage to them if they are dissatisfied with the terms the primary insurers agree upon.

Congress was aware that primary insurers and their reinsurers have this mutual interest in standardization of primary insurance coverage terms. It could not, therefore, have intended the McCarran exemption for cooperation on forms to be forfeited when reinsurers become involved. To the contrary, since the legislature viewed standardized coverage terms as a critical means of facilitating reinsurance, Congress must have intended the exemption to apply to efforts by primary insurers to determine the reinsurability of their proposed coverages.

This reading of the legislative history is consistent with the broad scope of the exemption that Congress granted to form standardization and with the views of the proponents of the "boycott" exception. The first antitrust immunity bills introduced after the Justice Department's indictment in *South-Eastern Underwriters* would have afforded insurers a blanket antitrust exemption, that is, one not conditioned on state regulation. *See* H.R. 3269, H.R. 3270 and S. 1362, 78th Cong., 1st Sess. (1943). The lead bill, H.R. 3270, was passed by the House and by the Senate Judiciary Committee, but a significant minority, led by Senator O'Mahoney of Wyoming, opposed it. The dissenters had two objections. One was that the bill would immunize rates and forms promulgated by rating bureaus that were not subject to state regulation. The second concern was over boycotting practices, such as had been the subject of *South-Eastern Underwriters*, used to privately enforce adherence to rating bureau rates and forms in those states that did not compel adherence by statute.

The first objection ultimately was resolved by the adoption, in § 2(b) of the Act, of a requirement that the challenged conduct be "regulated by State law."

Under this standard, the authors of the legislation clearly intended that agreements on rates and forms reached within rating organizations be exempt when the states required the rates and forms to be filed and reviewed. *See, e.g.*, 91 Cong. Rec. 1,481 (remarks of Sen. Ferguson) ("What we saw as wrong was the fixing of rates without statutory authority in the States"); 90 Cong. Rec. 6,561 (1944) (remarks of Rep. Anderson) ("[If] the State does not pass any rate-making regulations or if a State does not attempt to enact them, then, of course, the companies are subject to antitrust prosecution. But they are completely absolved from it if the rates are first submitted to a State authority and approved by that State authority.").

This broad immunity for rating organization rate and form agreements did not offend those advocating a "boycott" exception. To the contrary, they had always agreed with the NAIC's original proposal, upon which the Act was based, of an exemption for "all reasonable, cooperative procedures necessary and incidental to the establishment of statistical rate bases, rates, coverages and related matters." S. Rep. No. 1112, 78th Cong., 2d Sess. 6 (1944) (minority views, quoting NAIC proposal).

The evolution of the bills that ultimately resulted in the McCarran Act thus demonstrates that even the proponents of the "boycott" exception regarded the McCarran exemption as applying not only to the end product of joint action through rating organizations—the rates and forms themselves—but also to the antecedent process of conferring on and reaching agreement on those terms, so long as the rates and forms were subject to subsequent state review. They agreed with the original sponsors of the exemption that state regulation of the results of industry collaboration was the appropriate corrective to any subversion of a rating organization's "cooperative procedures" that were "necessary and incidental" to agreeing on the regulatory filing. This made it unnecessary for the "boycott" exception to apply to conduct that was

ancillary to "the establishment" of rates and coverage terms.

Given congressional awareness that an important purpose of form standardization was to promote the availability of reinsurance, Congress must have considered reinsurer participation in the development of standardized forms to be one such type of "necessary and incidental" cooperative procedure that enjoyed antitrust immunity to the same extent as the ultimate agreement on rates or coverage terms.

B. Plaintiffs Have Alleged Nothing More Than the Interaction Between Insurers and Reinsurers on Standard Coverage Terms That the McCarran Act Exempts.

The court of appeals construed the complaints as charging defendants with "much more" than merely "conferr[ing] and agree[ing] on the terms on which insurance would be offered." Pet. App. 21a. Carefully read, however, the plaintiffs' specific factual allegations in the forms standardization claims aver nothing more than (1) conduct that is necessary and incidental to joint action on forms and (2) a restraint of trade that naturally flows from that collective action.

The essence of plaintiffs' reinsurance boycott theory is that ISO members allegedly were coerced to amend ISO's original 1984 proposals by reinsurer "threats," allegedly solicited by the defendant insurers, that reinsurance would not be available for those coverages if adopted. The leverage allegedly employed by the reinsurers, therefore, was their control over the availability of reinsurance for the proposed but unadopted coverages, not their power over existing or different lines of reinsurance.

This type of reinsurer influence over standardized forms is entirely consistent with Congress' understanding that a key goal of these forms is to assure the availability of reinsurance. In the case of CGL insurance, to accomplish this effectively, ISO insurers had to ask domestic

and foreign liability reinsurers if they were willing to provide reinsurance for the coverages contained in the proposed 1984 forms. Indeed, state regulators assessed the ISO proposals in terms of this significant reinsurability question. *See, e.g.*, Banfield Aff. App. N.

Moreover, in the course of advocating their views, reinsurers did not exercise any leverage based on their control over a reinsurance product unrelated to the coverages under consideration. Their input was confined to the reinsurability of the proposed coverages and thus was "necessary and incidental" to the reaching of agreement by insurers and reinsurers on coverage terms that would optimize the availability of reinsurance. The reinsurer "economic power" regarded by the court of appeals as coercive merely reflected the fact that, to attract reinsurance capacity, standardized coverage terms must gain market acceptance from a significant number of reinsurers.

Nor did the defendants' actions have any impact on policyholders or primary insurers that was not the inevitable consequence of the industry action and state regulation contemplated by the McCarran exemption. The only effect of defendants' conduct in the primary insurance market was to substitute one set of standardized coverages for another—exactly what the McCarran Act permits. Moreover, the 1986 ISO forms criticized by plaintiffs could be used only in jurisdictions where state regulators had approved them or declined to disapprove them. The unavailability of a different standardized form in those states reflected a sovereign regulatory judgment that the 1986 forms more appropriately balanced the interests of insurers and policyholders. In states where one or both of the 1986 forms were rejected, they could not be used. This was exactly the type of intervening regulatory oversight—between the proposal of the form and its implementation in the market—which the authors of the McCarran Act regarded as a sufficient safeguard against monopolistic practices.

Nor was there any impact on the reinsurance market that was not also an inevitable result of state-regulated joint action on forms. There was no "refusal" to sell reinsurance to primary insurers alleged in the form standardization claims except reinsurance for the proposed 1984 coverages. Those coverages never went into effect before they were superseded by the 1986 ISO filings. Since those primary insurance coverages were never implemented in the market, the unavailability of reinsurance for them was purely a consequence of the joint action permitted by McCarran (the substitution of one standardized form for another) and the type of state regulation regarded by Congress as sufficient to confer immunity (approval of the substitute forms).[6]

In sum, the lower court was simply wrong in concluding that the plaintiffs had alleged "much more" than what normally occurs in the negotiating process over standardized forms and what normally results from state approval of those forms.

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[6] Specific state oversight of the alleged reinsurer activities is not necessary for McCarran Act purposes. In contrast to the state action doctrine, *see, e.g., FTC v. Ticor Title Ins. Co.*, 112 S. Ct. 2169 (1992), the state regulation requirement of the McCarran Act requires only that the state have the jurisdiction to regulate the challenged conduct or its effects, not that it do so actively or effectively. *See, e.g., FTC v. National Casualty Co.*, 357 U.S. 560, 564 (1958); *Ohio AFL-CIO v. Insurance Rating Bd.*, 451 F.2d 1178, 1184 (6th Cir. 1971), *cert. denied*, 409 U.S. 917 (1972).

In this litigation, the McCarran Act requirement was satisfied because the states had full power to redress the only alleged impact of the reinsurer conduct—its influence on the contents of standardized forms. The states had ample authority to approve or disapprove the proposed coverage terms under statutory standards requiring that the terms be fair and reasonable to policyholders. Such regulation has long been deemed sufficient for McCarran purposes. *See, e.g., Freier v. New York Life Ins. Co.*, 679 F.2d 780, 782 (9th Cir. 1982). In addition, the states had separate regulatory authority to prosecute the reinsurer defendants for unfair insurance trade practices. *See* Part II, *infra*.

C. The Ninth Circuit's "Boycott" Standard Should Be Rejected Because It Will Frustrate the McCarran Act's Policy Favoring Form Standardization.

Because the lower court condemned as a "boycott" conduct that is an integral aspect of form standardization, its boycott standard thwarts Congress' intent that the states be permitted to authorize cooperation on forms as they see fit. The decision is an open invitation to antitrust claims collaterally challenging state regulatory approval of standardized forms developed with the input of reinsurers.

Antitrust plaintiffs could defeat McCarran Act immunity merely by alleging that the give-and-take between insurers and reinsurers, during the negotiations over the reinsurability of proposed coverages, constituted non-exempt "boycott" or "coercion." Dismissal on the pleadings would be impossible, since the theory of the complaint would meet the Ninth Circuit's test. Summary judgment might well be unavailable, because there would often be factual issues concerning the extent of the reinsurers' "economic power" and the "coercive" intent of the defendants.

The resulting threat of antitrust sanctions will make insurers extremely wary about involving reinsurers in the form standardization process and reinsurers reluctant to participate. Ironically, therefore, although the decision below seeks to redress an alleged restriction in the availability of reinsurance, it will hasten that very result. The decision will erect a new Sherman Act barrier to reinsurer involvement in the form standardization process that will lessen, not increase, the chances that domestic and foreign reinsurers will extend reinsurance to new types of U.S. primary insurance coverages.

Moreover, the chilling effect of the Ninth Circuit's decision on form standardization will not be limited to instances where primary insurers interact with reinsurers. Many insurers are also reinsurers, ceding risks

in some cases and assuming them in others. When a carrier is active in both markets, it will be nearly impossible to determine when its opposition to a proposed form is in its capacity as a primary insurer, and therefore exempt, or in its capacity as a reinsurer, and therefore non-exempt under the lower court's approach.

The court of appeals' "boycott" standard could also apply in a context broader than reinsurance. It defined "boycott" as any use "of the economic power of a third party to force the boycott victim to agree to the boycott beneficiary's terms." Pet. App. 23a. The lower court wrongly regarded reinsurers as unrelated "third parties" to the form standardization process because it failed to perceive the essential interrelationship between insurance and reinsurance.

There are many other risk-sharing mechanisms within the insurance industry whose participants could similarly be misperceived as "third parties" at risk of antitrust sanctions if they seek to shape the contents of standardized forms. Property and casualty insurers often need to obtain specialized coverages for catastrophic or unusual risks from underwriting pools or syndicates. Insurers also cooperate in covering the same risks "through a process of 'layering' " involving levels of "primary" and "excess" insurance. *The Pricing and Marketing of Insurance: A Report of the Department of Justice to the Task Group on Antitrust Immunities* 201, 202, 210 (Jan. 1977).

Under the lower court's approach, these risk-spreading mechanisms could be regarded as "third parties" selling a product over which they had "economic power" because primary insurers needed access to it. Opposition by such entities to a proposed coverage, taking the form of an unwillingness to accept risks on those terms, might then be deemed a "boycott" under the economic coercion theory relied upon by the lower court. It would make no difference that these "third parties" have as legitimate an interest in coverage terms as reinsurers because they too are sharing the same risks.

In sum, the fundamental flaw in the lower court's "boycott" standard is that it ignores the risk-spreading nature of the insurance business and the need for the parties sharing risk to deal with one another concerning the terms they will accept. Congress, in contrast, understood very well that the risk-spreading function of insurance can be effective only "as a result of joint action and cooperation." 90 Cong. Rec. 6,536 (1944) (remarks of Rep. Howell).

Because it ignores this quintessential aspect of the insurance business, the lower court's boycott standard will have a chilling effect on the development of standardized forms by putting insurers at risk of antitrust sanctions for the frank exchange of views on the acceptability of coverage terms that is critical to reaching consensus. The lower court's boycott ruling will thus controvert Congress' policy judgment that the states should be free to permit industrywide debate and negotiations on coverage terms that would not be permissible if the Sherman Act were to apply.

D. The Termination of Rate Statistical Support for Obsolete Standardized Forms Cannot Be Considered a "Boycott" Because It Is Incidental to the Implementation of New Standardized Terms.

State approval of the ISO form filings in 1986 was, in effect, a determination that those forms should be the governing standard in CGL markets rather than the predecessor 1973 form, which the 1986 proposals were intended to modify. After the states had approved the new forms, ISO accordingly terminated rate statistical support for the 1973 form since it was no longer the industry standard.

Plaintiffs alleged that this action had no immunity because it constituted the denial of an essential service designed to coerce use of the 1986 rather than 1973 forms. *See, e.g.*, Cal. Compl. ¶¶ 97-100. In reversing summary judgment, the lower court noted and reinstated this allegation, without analysis. *See* Pet. App. 11a (referring to allegation that "ISO withdrew its data collection and risk-estimation support for the pre-1984 form").

As with the reinsurance boycott allegations, the appellate court's reinstatement of this allegation was grounded on a basic misunderstanding of industry practices. Form standardization and statistical cooperation are two sides of the same coin. Standardized forms are necessary to provide a uniform framework for the collection of statistical data on losses; rates are then developed for the standardized coverages contained in those forms. Congress thus regarded joint action on rates and forms as indivisible. *See, e.g.*, H.R. Rep. No. 873, *supra*, at 8-9 ("The theory of insurance is the distribution of risk according to hazard, experience, and the laws of averages. . . . Obviously, these factors, in their bearing upon *rates and forms of policies* can best be determined through cooperative action"); 90 Cong. Rec. 6,526 (1944) (remarks of Rep. Hancock) ("[T]he public interest in insurance lies in encouraging cooperative action, and of necessity it tends to uniformity and the maintenance of uniformity in *rates and forms of coverage*. This is a fundamental theory of regulation as it now exists") (emphasis added).

The lower court's reinstatement of plaintiffs' allegation respecting ISO support services squarely conflicts with Congress' understanding of the inseparable nature of ratemaking and form standardization. The court of appeals illogically assumed that Congress, on the one hand, intended to permit insurers to adopt standard coverage terms—which necessarily contemplates the freedom to replace one industry standard with another—but, on the other hand, did not intend to allow similar freedom in limiting the scope of ratemaking services the only purpose of which is to support the industry standard.

The lower court's ruling thus nullifies the McCarran Act's policy of permitting the states to authorize insurers to agree on one system of coverages. Rating organiza-

tions will now be at risk of antitrust penalties if they do not provide ratemaking support for coverages that compete with the standard policy.

E. This Court Should Establish a "Safe Harbor" Rule for Form Standardization Encompassing All Conduct Limited to Agreements on Terms and Conditions or Ancillary to Those Agreements.

A proper interpretation of the McCarran Act's "boycott" exception must give effect to the primary purpose of the exemption, which was to protect joint ratemaking and form standardization. Although the lower court acknowledged that immunity for these types of joint action "is incontestible," Pet. App. 21a, it then eroded that principle by characterizing as a "boycott" conduct which is a necessary incident of permissible industry cooperation.

To make the immunity recognized by the lower court meaningful requires a "safe harbor" not only for ultimate agreements on rates and forms but for practices that are necessary to reaching and implementing those agreements. Unless the antecedent consensus-building process, as well as subsequent rating organization support of joint rates and forms, is clearly protected, the immunity for state-authorized agreements on rates and terms will become meaningless. Insurers would still be subject to treble damage judgments and other antitrust sanctions for conduct that is a necessary incident of those agreements. The lower court's approach offers no such safe harbor because immunity would depend on uncertain fact-based inquiries into subjective intent—whether an agreement on rates and forms was reached voluntarily or was coerced—and on a Sherman Act market power analysis—whether the parties that coerced the agreement had "economic power."

A meaningful "safe harbor" approach to antitrust claims against rating organizations should weed out, by early dismissal, those directed at the core practices McCarran meant to protect. Where conduct is alleged to have coercively influenced insurer actions on rates or

terms, the allegations should initially be scrutinized to determine whether the conduct resulted in some anti-competitive restraint different from the restrictions that are a foreseeable consequence or anticipated result of joint action on rates and coverage terms.

Such a standard would implement the statutory intent consistently with the "boycott" exception, because there would be no automatic immunity for refusals to deal or similarly coercive conduct imposing a restraint that does not normally flow from reaching agreement on rates and terms or from implementing those agreements. Where the allegedly coercive activity results in a restraint that is not ancillary to standardized rates or terms, then there should be a more fact-based inquiry to determine whether the conduct constitutes the type of enforcement activity that falls within the boycott exception.

In this case, plaintiffs' allegations relating to reinsurer involvement in the forms development process should be dismissed on their face. Because one function of the form standardization process is to test the willingness of reinsurers to accept the proposed coverages, their unwillingness to do so cannot conceivably result in a restraint outside the scope of the exemption. Conversely, a threatened cutoff of all reinsurance, such as alleged by the Justice Department in *South-Eastern Underwriters*, should fall outside this "safe harbor" because a denial of reinsurance on any terms imposes a restraint broader than necessary to test the availability of reinsurance for a proposed coverage.

The legislative history of the "boycott" exception is consistent with this test. The proponents of the "boycott" exception were not concerned with conduct that was a necessary incident of reaching agreement on rates, policy forms, or terms, but rather with practices designed to impose those agreements on others by denial of all access to some essential facility or input, that is, by an agreement that went beyond joint action on the terms or price of insurance coverage.

Of primary concern were threats to exclude or expel an insurer from a rating organization to compel it to use bureau rates or forms. Exclusion from a rating organization was contrary to the purpose of the exemption since the concept of industrywide form standardization requires participation by all interested insurers. *See, e.g.*, 90 Cong. Rec. 6,560 (1944) (remarks by Rep. Celler) ("All companies should be permitted entrance to [a rating] conference—large and small, mutual and non-mutual—all should be permitted to participate in a rate conference. No company shall be excluded.").

The authors of the "boycott" exception were also concerned about similar attempts to deny all access to a product or service essential to competitive viability, such as all access to sources of reinsurance or insurance whatever the terms. *See, e.g.*, S. Rep. No. 1112, *supra*, at 5 ("In the case of some of the regional fire-insurance organizations, members are required to withhold reinsurance from nonmember companies no matter how well the risk may be secured. It has been alleged that some board companies have agreements with selected broker organizations whereby no business would be accepted from brokers who are not members of these organizations."). Total denial of access to essential markets is not a reasonable incident of joint action on rates or coverage terms because the refusal to deal with the targeted entities goes beyond a mere refusal to do business on the proposed or agreed terms. But so long as the joint action is confined to a state-regulated agreement on terms or rates, or is a necessary incident of reaching or implementing such an agreement, the authors of the McCarran Act intended immunity to be available.

II. THE NINTH CIRCUIT'S "FORFEITURE OF IMMUNITY" RULING SHOULD BE REVERSED BECAUSE IT WILL EXCLUDE ESSENTIAL PARTIES FROM THE FORM STANDARDIZATION PROCESS, CONTRARY TO CONGRESS' INTENT.

The insurance policy forms challenged by the plaintiffs were regulated in all of the relevant states by laws re-

quiring or authorizing state regulators to review them for fairness to policyholders. Pet. App. 48a-49a. The court below nevertheless denied immunity to the domestic insurer and reinsurer defendants based on plaintiffs' allegation that they acted in concert with foreign-based reinsurers allegedly not subject to the states' jurisdiction. *Id.* at 20a. In effect, the lower court engrafted a new "non-exempt entity" exception onto the McCarran exemption, permitting application of the federal antitrust laws whenever a plaintiff alleges that an out-of-state or unregulated party influenced the development of a standard rate or form.

At a minimum, this ruling threatens to impede the access of U.S. primary insurers to the global reinsurance market. Reinsurance is a highly international business because prudent spreading of risk requires a broad capital base and diversification of exposures. The capacity provided by foreign reinsurers is thus important to the U.S. market. In 1990, 35 percent of reinsurance purchased by primary insurers in the United States, totalling $5.15 billion in premiums, was obtained from foreign reinsurers not affiliated with a U.S. parent. *See* Reinsurance Association of America, *The U.S. Reinsurance Market in 1990: An Analysis of Annual Statement Data* 6, 8 (1992). Companies in the United Kingdom, including the Lloyd's of London syndicates and "London Company" reinsurers named as defendants in this case, sold the most reinsurance, accounting for approximately $1.9 billion in premiums. *See id.* at 5.

U.S. insurers will now be deterred from involving these foreign reinsurers in their forms development deliberations by the threat of antitrust sanctions. The likely effect of freezing these reinsurers out of the forms development process will be to reduce the availability of reinsurance from offshore sources. This result would be contrary to Congress' intent, because it intended to protect the traditional ties between U.S. insurers and British reinsurers. *See Joint Hearing Before Subcomms. on the*

Judiciary on S. 1362, et al., 78th Cong., 1st Sess. 265, 269 (1943).

The lower court's "forfeiture of immunity" ruling will also frustrate the McCarran Act's policy of allowing the states to authorize form standardization. It will do so by creating an antitrust deterrent against the participation of any unregulated, and thus "non-exempt," entity in the forms development process.

No state restricts participation in the standardization process to insurers or other insurance entities licensed within the particular state. State laws permit and, indeed, encourage unregulated but nevertheless interested parties to express their views on the proposed forms and rates being considered by insurance rating organizations. Those entities include professional actuarial societies, organizations representing agents and brokers, and groups representing insureds.

For example, in this litigation, the largest association representing the interests of commercial insurance purchasers, the Risk and Insurance Management Society, actively expressed its views concerning the proposed CGL forms. *See* Banfield Aff. ¶ 18. In addition, nationally-operating rating organizations file rates and forms throughout the country notwithstanding that many of their members are unregulated in some filing jurisdictions because they do not transact business in all fifty states.

However, if rating organizations continue to permit these "non-exempt" entities to participate in the form standardization process, they risk losing immunity if an antitrust plaintiff later alleges that there was collusion with the unregulated parties. Indeed, under the Ninth Circuit's approach, immunity would be stripped away even if a plaintiff did not allege that the agreement between the regulated insurers and the unregulated parties amounted to a "boycott." Rather, the effect of the involvement of an unregulated entity would be that the entire cooperative enterprise would fail to be "regulated

by State law," even if the states thoroughly regulate rating organizations and the forms they develop.

The dilemma for insurers created by the lower court's decision, therefore, is either forfeiting their antitrust immunity or shutting out the voices of those whose consensus is necessary if standardized coverage terms are to have customer acceptance and attract reinsurance capacity. In this respect, the lower court's "forfeiture of immunity" principle runs directly counter to Congress' concern, when adopting the "boycott" exception, that there be the broadest possible access to rating organizations due to their influence over standardized forms and rates.

The present system of nationally uniform commercial coverages could also fragment into a system of single-state coverages as insurers seek to avoid contact with out-of-state entities. The decision below will thus make it more difficult for U.S. businesses to know what they are buying and to obtain nationally uniform coverage.

For these reasons and as urged by the Solicitor General,[7] a conduct-oriented, rather than entity-oriented, test should be used in applying the McCarran Act's state regulation requirement. If the challenged conduct or its effects are subject to state regulatory jurisdiction, then the exemption should apply irrespective of the involvement of some entities outside the jurisdiction of the relevant states.

This test is consistent with the language of the exemption, which requires state regulation of the "business" of insurance, not regulation of insurance "companies" as entities. *SEC v. National Sec., Inc.*, 393 U.S. at 459. It is also consistent with the Act's policy of federal deference to state regulation. *See Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429 (1946) (the purpose of the McCarran Act was "broadly to give support to the existing and future state systems for regulating and taxing the business of insurance").

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[7] *See* Brief of the United States as *Amicus Curiae* in Opposition to Petition for Certiorari at 7-9.

Finally, a conduct-oriented standard is consistent with the interpretation of the state regulation requirement in *FTC v. Travelers Health Ass'n*, 362 U.S. 293 (1960). In determining whether the McCarran Act exempted insurers from the Federal Trade Commission's authority to prohibit deceptive practices, the Court concluded that "the state regulation which Congress provided should operate to displace [the FTC Act] means regulation by the State in which the deception is practiced and has its impact." *Id.* at 298-99.

In the present cases, the impact of the alleged forms standardization conduct was felt in the relevant states through the use of the ISO forms, which every state had the authority to approve or disapprove. Thus, notwithstanding the involvement of offshore reinsurers, state regulators had plenary power to remedy the effects of defendants' conduct on policyholders such as plaintiffs, by approving or disapproving the proposed coverage terms. In addition, the states had separate regulatory authority, under their unfair insurance trade practices laws, to prosecute the reinsurer defendants for any conduct having an adverse effect on insurers or policyholders within the state. Standing alone, this type of regulation is sufficient to displace the federal antitrust laws. *See, e.g., FTC v. National Casualty Co.*, 357 U.S. 560 (1958).

Removing antitrust immunity notwithstanding these laws would permit use of the Sherman Act to override state approval of forms and supplant state regulation of reinsurers, thus "impairing, invalidating or superseding" state regulation in the very manner prohibited by the McCarran Act.

CONCLUSION

The judgment of the court of appeals should be reversed.

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